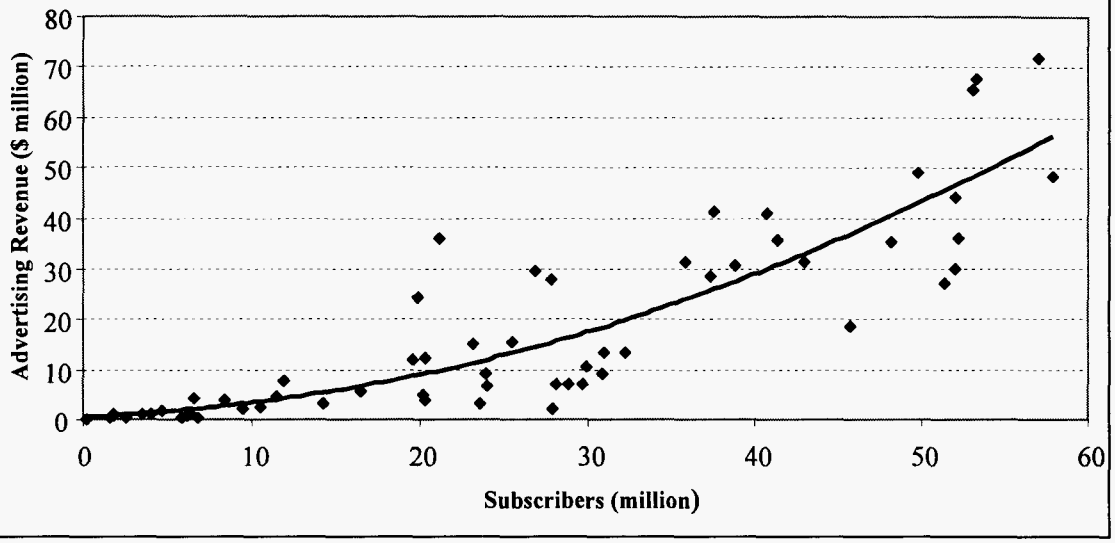
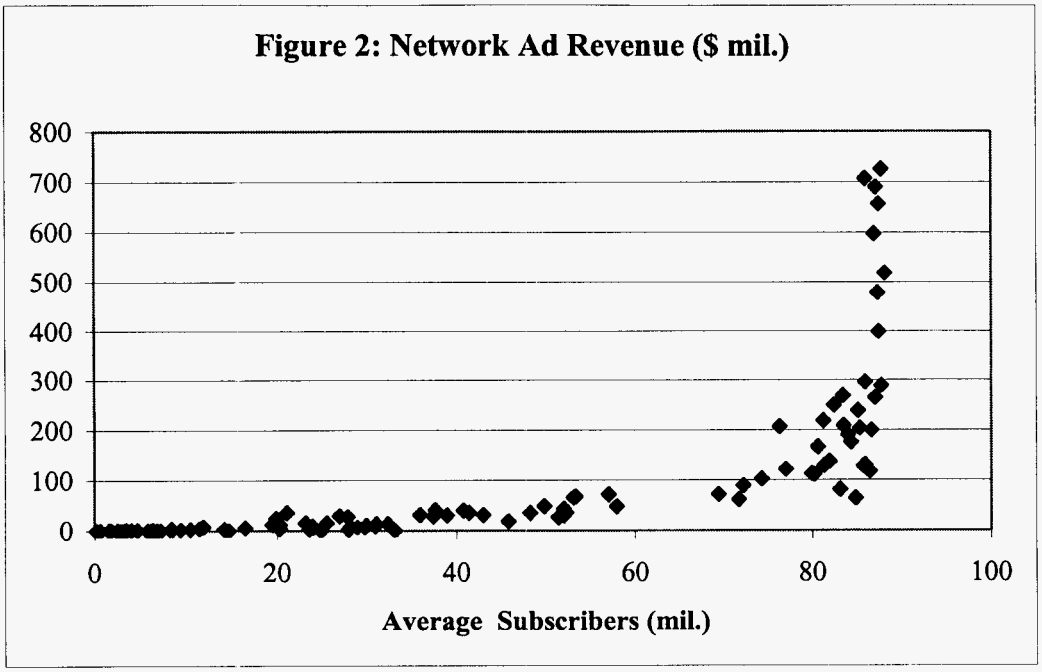
Figure 1: Networks with Less than 60 Million Subscribers



However, as a network obtains carriage on most MVPDs and reaches around 70 to 80 million subscribers this relationship breaks down. Figure 2 depicts net advertising revenue in 2003 for 105 cable networks plotted against their subscriber bases. As Figure 2 makes clear, though the size of the subscriber base is important, advertising revenue is not solely a function of subscribers for networks beyond a certain subscriber level. Several factors affect the CPM that impressions can command in the advertising market. The demographic characteristics of the viewers are obviously important to advertisers. Two factors that are not as obvious are the accuracy with which impressions are measured and the reach of the network.



Discussion with ABC Network and ESPN Network advertising sales personnel indicated that, as a rule of thumb, a cable network currently needs a subscriber base of around 50 million households before most national advertisers consider purchasing time on it. One reason for this is the desire for accuracy in measurements of audience size. Nielsen estimates the number and type of viewers for television programs based on a small sample of viewers. Therefore, if a program does not reach certain minimum viewing levels, its ratings are highly variable and statistically less reliable. We have been informed that Nielsen ratings are not normally available for networks with less than 20 million subscribers and are usually not statistically stable for networks with less than about 50 million subscribers. There are advertisers who want reliable ratings information on a network before considering purchasing advertising on that network. Therefore, when a network reaches approximately 50 million subscribers, there can be a jump in the CPM it can charge. Thus, bundling can increase CPM through helping a cable network reach a larger audience.

Another reason behind this rule of thumb is that national advertisers prefer broad reach and it is at the 50 million subscriber level that a cable network is available to about

half of all TV households. National advertisers see value in reaching a broad cross section of viewers at one time. Therefore, advertisers are willing to pay more per viewer for large sets of viewers. For example, an advertiser might purchase two ads that each deliver 500,000 viewers. But because there is likely some overlap in the audiences of these two ads, and the total viewers reached is likely less than one million, that same advertiser typically will pay more for an ad that delivers one million unduplicated viewers. Advertisers value unduplicated reach, and pay a pay a premium for a larger audience. For this reason, a 20 percent increase in audience size will increase advertising revenue by more than 20 percent for widely distributed networks.[8] This is one reason that broadcast networks still have higher CPMs than cable networks. Without bundling, the gap would be wider still, resulting in lower advertising revenues for cable networks.

Bundling Helps Achieve Distributive Efficiency

From the point of view of economic welfare it is important to distribute a program or network at a low marginal cost, while preserving incentives for programmers to invest. Programs are what economists call "non-rivalrous" or "public" goods—once a program exists, it costs nothing to let one additional viewer enjoy it. Therefore, it is inefficient to charge a price that excludes viewers who place any value on the program. Of course, there has to be a way to pay programmers, or there will be no programs. Bundling helps to solve this dilemma. Once a household is wired to receive cable or satellite, there is essentially no social cost associated with allowing the household to receive more signals. Viewers, for their part, typically receive some positive enjoyment from additional signals. Bundling cable networks, and pricing the bundle so that consumers do not pay more for viewing additional hours or additional networks, increases social welfare. For example, bundling makes economically feasible certain programming and cable networks that could not be supported with a la carte pricing.

---

8 For empirical support see Franklin M. Fisher, John J. McGowan and David S. Evans in "The audience-revenue relationship for local television stations," *The Bell Journal of Economics,* Autumn 1980, pp. 694-708.

Pay Services That Have Joined the Bundle

In recent years there has been a migration of premium services onto the basic services tier. Examples include Bravo, Disney and virtually all of the regional sports networks. These moves indicate a belief that being part of a bundled service tier is important to the economic success of the majority of programming services. Analogously, on-line services such as AOL have moved from per-hour to flat rate pricing, as have cell phone service suppliers. It seems that for any given expenditure, consumers prefer not to have to deal with metered usage.

Disney Channel is one of the services that migrated from being a premium service to a basic service during the 1990s. As a result of this move, Disney Channel increased its distribution from about 5 million premium subscribers to over 80 million basic subscribers.[9] Disney Channel was also able to reduce its expenditures on acquiring subscribers and focused more of its marketing efforts on getting consumers to watch its programming. As a result of having a larger subscriber base and greater license fee revenue, Disney Channel increased its programming expenditures, particularly its spending on original programming. With a larger subscriber base, in an effort to attract a larger audience, Disney Channel began targeting some of its programming toward narrower segments of the market. As a result, Disney reports that Disney Channel has increased its ratings, reach, and audience composition of African-American and other minorities since 2000.

Discriminatory Incentives for Bundling

Economic literature offers still another explanation for product bundling that depends on the incentive to discriminate among heterogeneous consumers. Bundling can be viewed as an implicit way to charge a higher price to those consumers who most value some components of the bundle and a lower price to those who value those components

---

9 Kagan Research, *Economics of Basic Cable Networks 2005: Key Spreadsheets*, June 2004.

least. Gregory Crawford presents an analysis of discriminatory incentives to bundle in the cable industry in a recent article.[10]

Prof. Crawford's results suggest that, on balance, bundling increases overall social welfare in cable television. Therefore, there would be social losses from unbundling. Crawford also finds that there are important distributional effects across consumers. The consumers who would lose most from bundling are those that place high value on only one or a few networks in the bundle, but are still willing to purchase the bundle. By contrast, bundling permits firms to lower prices (relative to the sum of unbundled prices) to the benefit of consumers that place moderate value on a large number of networks.[11]

Prof. Crawford recognizes, but does not incorporate into his analysis, the cost savings generated by bundling and therefore his results likely understate the social gains from bundling. He notes,

> The least cost method of providing any cable service is to bundle all the programming. This is due to the underlying technology of video program distribution: all television networks are transmitted to each customer's home. It is *unbundling* networks that is costly, requiring methods to prevent consumption by non-subscribers. (Page 9, emphasis in original.)

Additionally, referencing a recent GAO report, Prof. Crawford discusses two additional reasons why cable systems do not unbundle basic and expanded basic services. [12]

---

10 Gregory Crawford, "The Discriminatory Incentives to Bundle in the Cable Television Industry," University of Arizona (working paper), April 2, 2004.

11 Ignoring costs, Prof. Crawford finds that (discriminatory) bundling causes average consumer welfare to fall. (Page 20) It should also be noted that Prof. Crawford's study is based on cable industry data from 1996. That era is prior to the emergence of EchoStar and during the start-up period of DirecTV. The increased competition since 1996 may have allowed subscribers to capture a larger share of the benefits from bundling than they captured during the time period used in Prof. Crawford's analysis. This would reduce or eliminate average consumer welfare loss from bundling. Also, as discussed *infra*, Prof. Crawford does not incorporate the cost savings of bundling into his welfare analysis.

12 GAO, *Issues Related to Competition and Subscriber Rates in the Cable Television Industry*, October 2003 ("GAO Report").

> The first is that not all consumer[s] opt for addressable converters, even when offered by their system. Uniform deployment of converters, while likely in the long-run, could be costly at present. This raises the costs of unbundling. The second is that *networks* do not want to be unbundled. The average cable network earns about 50% of its revenue from advertising (GAO (2003)). Unbundling would clearly reduce the set of consumers that could watch a network and likely reduce the number that do watch. This would plausibly reduce advertising revenues and require uncertain increases in license fees to compensate." (Page 10, footnotes omitted.)

Nevertheless, his paper does not incorporate the cost-saving incentives to bundle, but rather focuses only on the price discrimination incentive to bundle.

Appendices B and C contain two simple models that show how subscribers may benefit from bundling. The model in Appendix B considers three consumers and two programming choices. The model illustrates that consumers can be better off with bundling than with a la carte. Appendix C presents a richer model. It contains a continuum of consumers, but still focuses on two programming choices. The model illustrates that pure bundling can produce greater consumer benefits than either a la carte or mixed bundling (a combination of a la carte and bundling), even ignoring the additional costs associated with unbundling. This is because, ignoring costs and given the model's assumptions, while some consumers may gain from a move to either a la carte or mixed bundling, more consumers will lose. In fact, in the model, most of the existing subscribers to the bundle are made worse off by unbundling. Uncertainty over how specific consumers will be affected is itself a strong argument against government intervention that results in retail unbundling.

III. EFFECTS OF UNBUNDLING

A government mandate that results in retail unbundling would be inefficient and harmful to cable networks, MVPDs, and consumers. Unbundling would likely reduce the number of subscribers to any cable network, and hence reduce license fee revenues (at current prices). It is also likely to reduce both a cable network's advertising revenue and an MVPD's advertising revenue. Additionally, it will increase a cable network's costs, an MVPD's costs, and a consumer's costs. The cable network will look to offset this

revenue loss and increased cost by increasing the license fee to the MVPD and/or by reducing the quality of its programming. The MVPD will respond by charging a la carte rates to its subscribers that exceed what subscribers now pay for the same collection of networks. These and other effects of unbundling are discussed below.

The analysis focuses on pure a la carte. As defined here, pure a la carte means the MVPD charges a flat fee for the basic service tier—consisting of broadcast television and PEG programming—and sells all other programming a la carte. Many of the conclusions also apply in a "mixed" environment. For instance, cable networks could be offered both a la carte and bundled by the same MVPDs, or a cable network could be offered a la carte by some MVPDs and bundled by other MVPDs. The conclusions also apply to cable networks that are split apart from other bundled networks and placed in a "theme" tier. The analysis considers how basic cable networks might be affected by unbundling and what impact this might have on consumers. The impact on MVPDs, or the exact response of MVPDs to changes in wholesale program pricing, is not examined in detail.

Impact on Consumer Demand

If a cable network were unbundled and offered a la carte, the immediate effect would likely be that it would lose subscribers. Previously, any consumer subscribing to the bundle received the network at no incremental cost; now, subscribers would be required to pay some positive price for the network. The consumers most likely to decline the network a la carte are those that place the lowest value on the network. The value of the network will differ from consumer to consumer, and will be affected by many factors, including consumers' income, the attractiveness of the programming and the availability of other programming that is perceived to be an adequate substitute. In general, the consumers placing a low value on the network are those who previously viewed the network least intensively when it was offered as part of a tier.[13] By the same logic, one

---

13 The impact of a la carte pricing on networks that are valued chiefly as an option depends on the ease with which consumers expect to be able to subscribe to it when a relevant contingency arises.

can expect that the consumers who choose to subscribe to the network a la carte will tend to be those that viewed the network most intensively when it was bundled.

It is beyond the scope of this paper to predict the subscriber loss that networks would experience moving to an unbundled environment, which would depend on the a la carte prices that MVPDs charge as well as many other factors. However, some insight can be gained by looking at the viewing intensity that various networks have experienced in the bundled environment. As an example, TBS Superstation is distributed to about 88 million homes. In May 2004, about 24 million homes (27 percent) did not view TBS Superstation at any time during the month. One might expect that, in an a la carte environment, most of these households would be unlikely to subscribe. If one defined "high-intensity" homes as those that tuned to a network at least 25 percent of the days in the month, TBS Superstation had 26.9 million high-intensity homes, making up about 31 percent of total bundled subscribers. Table 1 shows for a selection of networks the percentage of current bundled subscribing households who were high-intensity. Results could vary across time, particularly for networks like CNN and The Weather Channel that tend to be more event-driven.

Table 1. Viewership Intensity for Selected Basic Networks

	Total Homes	"High-Intensity" Homes	Percent "High-Intensity"
CNN	87.9	13.1	15%
Discovery	88.5	17.5	20%
TBS	88.0	26.9	31%
Weather Channel	87.6	14.6	17%

Source: ABC Networks, based on Nielsen data for May 2004.

If the subscribers in an a la carte world were the same as those that viewed the network with high intensity in the bundled world, based on these examples, networks

offered a la carte could expect to retain in the neighborhood of 15-30 percent of their current subscriber base.[14]

Impact on Advertising Revenue

As described above, the subscribers that a network would lose when moving to an unbundled environment would tend to be those who previously viewed the network with relatively low intensity. Because the subscribers who would be retained tend to watch the network more than those who would be lost, the percentage reduction in viewership would be a smaller than the percentage reduction in subscribers. Nevertheless, casual viewers and channel surfers can account for a substantial share of a network's viewing audience, and losing such viewers in an unbundled environment would lead to a decline in advertising revenues.

Table 2. Viewership Intensity and Audience for Selected Basic Networks

	High-Intensity Homes as Percent of Homes Receiving Network	High-Intensity Homes as Percent of Audience
CNN	15%	86%
Discovery	20%	57%
TBS	31%	69%
Weather Channel	17%	81%

Source: ABC Networks, based on Nielsen data for May 2004.

Like Table 1, Table 2 shows for selected basic cable networks the percentage of households that are "high-intensity." Table 2 also shows the percentage of the viewing audience that comes from the high-intensity homes. For TBS Superstation, for instance, such homes are only 31 percent of the subscriber base, but they account for 69 percent of the audience. For TBS Superstation, these households have a viewing intensity about twice that of the average household subscribing in the current bundled environment. Viewing appears to be somewhat more skewed towards the high-intensity viewers for

[14] This analysis does not consider whether these "high-intensity" homes would be willing to pay the price that would be charged for these networks if they were sold a la carte.

The Weather Channel and CNN, about five to six times the average subscribing household.

As a first approximation, one might naively expect the percentage reduction in advertising revenue resulting from unbundling to be about equal to the percentage reduction in audience. However, various other factors would tend to further reduce advertising revenues. For example, the remaining audience in the a la carte environment will tend to be less valuable because it is smaller.[15] As discussed above, advertisers value unduplicated reach and pay a premium for a larger audience. Additionally, fewer subscribers imply that ratings data will be harder to obtain for some networks. The absence of ratings data reduces advertising rates because of uncertainty over audience size and demographics. .

An offsetting factor that might reduce the loss of advertising revenue is a change in viewing patterns. Consumers that choose to take a network a la carte may watch the network more intensely than they did previously, because they would be decreasing their viewing of other networks to which they choose not to subscribe a la carte.[16]

Increased Network Costs Due to Unbundling

In an unbundled environment, a cable network would face additional marketing costs, since it would have to attract subscribers in competition with many other a la carte cable networks. A network's additional marketing costs would consist of subscriber retention programs, telemarketing, and subscriber acquisition programs, such as free previews of the network, promotional offers, direct-mail advertising, and consumer premiums. These expenditures are designed to increase the total number of subscribers

---

15 It is possible that if the network attracts a niche audience, advertisers of niche products may be willing to pay more per audience member for the a la carte audience than for the tiered audience. However, most advertisers sell products that appeal to a broad audience and purchase time to reach a broad audience. For such advertisers, there is little or no benefit, and perhaps a disadvantage, from restricting the audience to niche viewers.

16 If the network in question is one of only a few networks that are offered a la carte and its subscribers still subscribe to other basic networks on a bundled basis, this effect may not apply.

and to counteract the loss of households that discontinue their subscriptions. In addition to these marketing expenses, there are associated costs of the personnel needed to implement the marketing program.

In considering networks' marketing costs, it is important to bear in mind that moving to an a la carte environment would significantly change the way that consumers get information about networks. Unlike in a bundled environment, consumers would likely not be able to easily and costlessly browse other networks to sample their programming. Hence, there would be a significant reduction in consumer awareness of viewing options. To illustrate, imagine what would happen if the *Washington Post* were required to offer each section of the newspaper a la carte. Subscribers who now glance at, but do not read, certain sections would lose their current awareness of the content of such sections. When and if such content becomes relevant, they would have to engage in a relatively costly search process. For a new or repositioned network, the challenge of informing consumers about the network's programming would likely be much higher than in a bundled environment.

When it was marketed primarily as an a la carte service in the early 1990s (1990-93), Disney Channel spent about $17 million per year on customer acquisition and telemarketing costs and about $5 million per year on retention programs such as the *Disney Channel Magazine*. Since the network had around 4.6 million subscribers at that time, this translates to a cost of about $4.70 per subscriber per year. In addition to this cost, there were the costs associated with the personnel implementing the programs. Including personnel costs could double Disney Channel's acquisition cost per subscriber.

Impact on Program Quality and Diversity

Some of the effects of unbundling on network programming can be illustrated by considering ESPN. While ESPN is used for illustration, similar effects would apply to other cable networks as well. First, an unbundled ESPN is likely to offer less niche sports programming. In order to broaden its appeal to occasional viewers, ESPN has expanded the categories of sports that it offers, such as women's college basketball and the World Series of Poker. Compared to the bundled environment, it would be much more difficult

for ESPN to attract occasional viewers with specialized interests, because such consumers would have to contact their MVPD and start a subscription. Instead, ESPN would respond to the reduction in subscriber and advertising revenue resulting from unbundling by focusing on mainstream, broad-appeal programming to attract a core audience. This would likely hinder ESPN's ability to nurture the development of new audiences.

ESPN may also lose the ability to keep high-profile sports and sports events. The sellers of rights to televise sports and sports events want wide distribution.[17] With a smaller ESPN audience, the rights owners may well turn to other outlets. That is, if MVPDs shift ESPN to a la carte or a theme tier, rights owners may well seek substitute media with wider distribution. One possibility is that existing sports programming on ESPN would migrate to other cable networks with larger audiences. Such an audience differential would likely be most pronounced if ESPN is unbundled, or on a theme tier, and other cable networks remain bundled. In this case, unbundling ESPN accomplishes nothing as far as addressing any perceived link between high sports programming costs and subscription fees for consumers. The other possibility is that rights holders will find no suitable alternatives to ESPN and would simply drop the ESPN-type distribution outlet, limiting themselves to broadcast networks, regional sports networks, and high-end packages such as NFL Sunday Ticket. In that case, there would be a further reduction in sports programs available to the typical viewer compared to the bundled environment.

Impact on Subscribers

Offered as an individual service, a cable network would likely have fewer subscribers, a smaller audience, and increased marketing costs. Fewer subscribers means less license fee revenue, holding license fees constant. A smaller audience means less advertising revenue. Less revenue and increased cost reduces the funds available to acquire programming, and thus reduces the quality of programming available on the network, or raises subscriber price, or both.

---

[17] See GAO Report, pp. 38-39.

As the GAO noted, "under a la carte it is possible that cable rates could actually increase for some consumers."[18] This is because to the extent that networks want to maintain programming quality they will increase license fees to offset the decline in revenue and the increase in costs, and these license fee increases are likely to be passed on to subscribers. Indeed, the only way that networks can maintain their current level of programming expenditure (and cash flow) and offset the decline in advertising revenue and the increase in marketing costs is if, on average, subscribers pay more.

Instead of raising license fees to maintain programming expenditures, a network may respond by decreasing programming expenditures. However, any decrease in program quality is also a cost to consumers. It is also quite possible that a network may not be able to attract enough subscribers to support the network and may fail.[19]

Because consumers' expectations would likely be unfulfilled—due to unrealized savings, the reduction in program quality, or the exit of certain networks—there may be further pressure on Congress and the Commission to regulate cable rates and cable network and MVPD behavior.

Comments on "Mixed" A La Carte and Bundled Environments

As discussed above, if a network that was previously offered as part of a bundle begins to be offered a la carte, it will lose subscribers, audience, and subscriber and advertising revenue. To the extent that the network continues to be available as part of a bundle on some MVPDs, the effects are reduced. However, in such an environment, the network is likely to experience higher costs and lower efficiency than in either a pure bundled environment, as at present, or a pure a la carte environment. Networks would be forced to conduct two types of advertising and marketing simultaneously, which would tend to increase costs. In addition, because MVPDs offering the network a la carte may be scattered throughout the country, it would likely be less efficient to reach potential a la

---

18 GAO Report, p. 34.

19 See GAO Report, p. 36.

carte subscribers through mass media. It may also be more difficult for networks to choose optimal programming in this mixed environment, because the programming that would attract an audience in a bundled environment may be different from what would best attract a la carte subscribers. Uneven subscriber coverage throughout the country may also make the network less attractive when selling national advertising.

Under some proposals, such as a "theme tier," apparently most basic cable networks would continue to be offered as part of a bundle and a few networks would be offered in a smaller bundle. Those networks that are excluded from the principal bundle will experience reductions in subscribers and audience. In fact, the effects on subscribers and audience may be even greater than they would be in a pure a la carte environment. If only some networks are unbundled and placed in a theme tier, those unbundled networks will suffer for the same reasons that an a la carte network suffers. The networks excluded from the principal tier would have to attract customers who already had available to them a large bundle of networks, with the associated efficiencies of bundling enjoyed by the consumers, MVPDs and the included networks. Moreover, since the composition of the "theme tier" will be determined by individual MVPDs, a network may be part of the theme tier in some areas and part of the larger bundle in others. For the reasons just discussed, this may make it more difficult for a network to program, to promote itself, and to sell advertising. As the GAO noted, "Creating a greater number of smaller tiers could cause many of the same technological and economic concerns as an a la carte approach."[20]

---

[20] GAO Report, p. 30.

Appendix A: Examples of Spikes in Viewership

"Hanging on the wall of Cable News Network President Tom Johnson's office...is a bright-red chart with flat lines punctuated by occasional spikes that rise and fall in an unpredictable pattern. ...[T]he peaks and valleys on the wall document CNN's simple commercial truth: News sells. Each spike represents a major event since 1985, and the bigger the spike, the bigger CNN's viewer ratings. The explosion of Pan Am Flight 103 over Scotland, the Clarence Thomas hearings and the rescue of baby Jessica from an abandoned Texas well all generated strong numbers for CNN. And while the Persian Gulf war mustered record numbers for the cablecaster, CNN has found an even juicier draw in recent months: the O.J. Simpson trial. ...[A] major event such as the Simpson trial can more than double its audience." (*U.S. World & News Report,* April 10, 1995, p. 56.)

"Speaking of peaks, MSNBC said its viewership rose to more than 621,000 when police closed in on Andrew Cunanan in Miami during prime time." (*Electronic Media,* July 28, 1997, p. 3)

"As viewers flocked to coverage of Princess Diana's death, the cable-news networks drew un-accustomed kingly ratings. Cable News Network and relative newcomers Fox News Channel and MSNBC all reached ratings milestones with their Diana reportage." (*Multichannel News,* September 8, 1997, p. 19.)

"All three cable networks providing gavel-to-gavel coverage of the Simpson trial -- CNN, Court TV and E! -- say their ratings are up strongly." (*Mediaweek,* February 6, 1995, p. 5.)

"After years of struggling, regional cable news networks are finding an audience and advertisers. ... 'When there's a breaking news story, whether it's severe weather in the Pacific Northwest, a pipe bursting in New York or the inauguration in Washington, RNNs can grab five times their normal ratings,' said Stuart Zuckerman, director of sales at National Cable Communications, which sells national ads for seven major market RNNs..." (*Multichannel News,* April 14, 1997, p. 30A.)

"The Weather Channel and the three 24-hour local cable news outfits – Washington's Newschannel 8, New England Cable News and New York 1 – that covered the blizzard nonstop all reported huge ratings gains during the storm. ...[A] spokesman for Cable News network said its storm coverage caused a 20 percent jump in viewership on Monday, Jan. 8, over the previous Monday ratings. ...TWC set a ratings record on Jan. 7, when it averaged a 1.5 rating from 6 a.m.-midnight. The network's viewership peaked at 2.9, also the highest in its 13-and-a-half year history. In Washington, Newschannel 8 peaked at a 7 rating in its cable universe, which is about seven times its usual audience..." (*Multichannel News,* January 15, 1996, p. 12.)

"Naturally, folks at the [Weather] channel are always on the lookout for a really big storm. When Hurricane Erin hit in August, viewership jumped to 1.4 million. 'Hurricanes are like the O.J. Simpson trial for us,' says [Michael] Eckert," The Weather Channel's chief executive. (*Forbes,* October 23, 1995, p. 320.)

On September 6, 1995, Cal Ripken passed Lou Gehrig's record for consecutive games played. The ESPN Wednesday night game that night averaged a 6.98 rating, which is 320 percent greater than the 1995 season average of 1.66 for Wednesday night games. Following the game was coverage of "Cal Ripken Ceremonies," which attained an even higher audience--a 7.27 rating.

On January 6, 1994, Nancy Kerrigan was attacked in an ice skating arena in Detroit. On that evening, Sportscenter ESPN at 7PM averaged a 1.65 rating which is 42 percent greater than the previous day's rating, and 54 percent greater than the 1994 Sportscenter average of 1.07.

In October 1993, Michael Jordan announced his "retirement" from the NBA. Live coverage of this announcement on October 6 at 11am in a special edition of Sportscenter attained a 1.87 rating. Sportscenter at 7PM on that same day averaged a 1.61 rating, which is 45 percent greater than the previous day's rating and 30 percent greater than the 1993 season average.

Some movies on Lifetime, such as "Any Mother's Son" and "Fifteen & Pregnant," have generated ratings over three times as high as the network's average prime-time rating.

Some documentaries on Discovery, such as "Titanic: Anatomy of a Disaster," "Raging Planet" and "Wolves at Our Door," have generated ratings at close to or over three times as high as the network's average prime-time rating.

The Comedy Central program "South Park" has achieved ratings four times higher than the network's average prime-time rating.

Some movies on TNT, such as "Buffalo Soldiers" and "Last Stand at Saber River," have generated ratings over three times as high as the network's average prime-time rating.

Some movies on TBS Superstation, such as "Dumb & Dumber" and "Total Recall," have generated ratings over three times as high as the network's average prime-time rating.

Appendix B: Example of Inefficiency from Unbundling

This appendix provides a simple example to show how unbundling can make some or even all consumers worse off. Consider a cable operator that carries two networks—Network X and Network Y.[21] Assume that, for every viewer (A) who really values the programming on Network X, there are two viewers (B and C) who care relatively little about Network X. Assume further that the representative Viewer A values Network X at $150 per year and Network Y at $60 per year; in contrast, the other two typical viewers value Network X at only $20 per year and place a total annual value on Network Y of $200. The representative subscribers' valuations of the programming networks are presented in the following table. For purposes of this example, it is assumed that the marginal cost of supplying a subscriber with either Network X or Network Y is zero.

SUBSCRIBER VALUATIONS OF PROGRAMMING NETWORKS			
	Network X	**Network Y**	**Total**
Viewer A	150	60	210
Viewer B	20	200	220
Viewer C	20	200	220
Total	190	460	650

[21] Networks X and Y can be though of either as individual cable networks or bundles of cable networks.

Under the current arrangement in which all networks are bundled together, the cable operator charges a bundled price of $210 per year to all viewers, because this is the price that gives the cable operator the most profit. Revenue at this price equals $210 for each of the three viewers, or $630 total. If the same cable operator offered the networks a la carte, the operator would price Network Y at $200 per year. It would choose this price because if it set the price sufficiently low to induce Viewer A to purchase Network Y ($60 in this example), it would have to lower price to all viewers, and it is more profitable to sell Network Y to two viewers at $200 each than to sell it to all three at $60. Similarly, the cable operator would offer the Network X at $150 to one viewer rather than drastically reducing the price (to $20) in order to sell it to all the viewers.

In this example, unbundling makes everyone worse off. The cable operator's revenue drops significantly (as do its profits, since its costs are essentially unaffected by the number of signals viewers choose to receive). Perhaps less obvious is the fact that consumers are worse off as well. In particular, Viewers B and C are hurt by the regulation because they lose Network X's programming that they value at $20/year, but they save only $10 in annual cable bills. On balance, both viewers are $10 worse off than if they were "required" to purchase Network X. Viewer A loses programming valued at $60, but at least he saves that much on his cable bills. Social welfare is also reduced. This is because Viewer A no longer receives $60 in enjoyment from viewing Network Y. Similarly, the other viewers no longer each receive the $20 in benefits from Network X. Social welfare is reduced by $100 because viewer benefits have fallen $100 without any offsetting cost savings to society.

Offering the networks a la carte reduces total welfare because it induces pricing so as to exclude some consumers. This effect is most pronounced when the value of a network is concentrated in a relatively small number of viewers, and when these viewers derive most of their utility from a small number of networks. Under those circumstances, the cable operator will tend to price the a la carte offering so as to exclude a large number of viewers with low valuations for a particular channel. While all networks are produced, distribution is severely limited under these circumstances and total welfare suffers as a result.

Similarly, unbundling particular networks (or forming a small tier of similar networks) may result in severe welfare losses, particularly if such networks are highly valued by a relatively small number of subscribers. The losses occur because profit-maximizing cable operators would price the small tier of networks in such a way as to exclude many viewers with relatively low valuations for the networks. Moreover, the cable operator will price the bundle of remaining networks at a level that excludes those who derive most of their viewing enjoyment from the a la carte or mini-tier offering.

Appendix C: Example of Inefficiency from Unbundling or Mixed Bundling

This appendix uses an extended numerical example to illustrate the effects of unbundling on consumer welfare, which are complex. This example abstracts from welfare losses arising from advertising revenue/audience size feedback effects and also ignores welfare losses arising from increased consumer search costs and increased supplier marketing costs. While the precise magnitudes of the effects depend on the specific numeric values chosen, the general conclusion is that departures from bundling can make a sizeable portion of consumers worse off.

Consider a cable operator that carries two networks—Network X and Network Y.[22] The operator can market these networks to consumers under one of three possible regimes. Under an a la carte regime, the operator sells each network separately. Under the pure bundle regime, the operator sells the networks only as a bundled product. Under the mixed bundle regime, the operator offers to sell the networks both individually and as a bundle.

Assume that consumer preferences for each network are uniformly distributed identically and independently from $0 to $1 for each network.[23] That is, consumers can be thought of as being uniformly distributed across a unit square, with any given consumer's valuation of Network X being measured along the x-axis and the consumer's valuation of Network Y measured along the y-axis. See Figure C1.[24] Also assume, for purposes of this example, that the marginal cost of supplying a subscriber with either Network X or Network Y is zero.

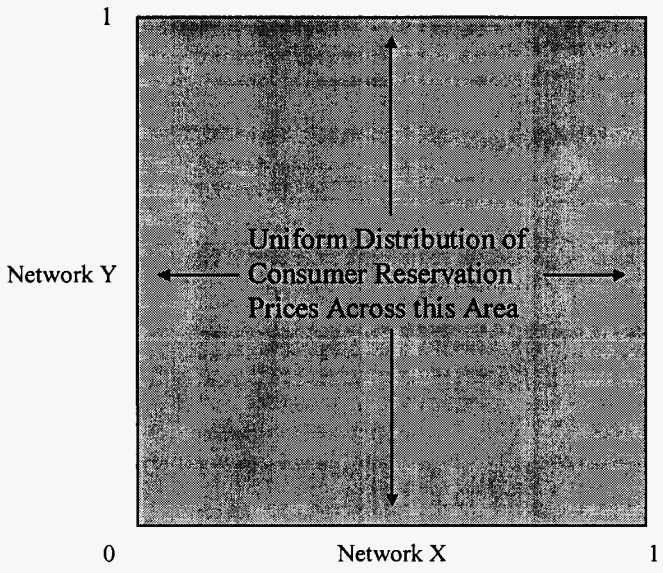
---

22 Networks X and Y can be though of either as individual cable networks or bundles of cable networks.

23 The upper bound of the range is not important and does not affect the analysis.

24 See Adams and Yellen, "Commodity Bundling and the Burden of Monopoly," *Quarterly Journal of Economics*, Vol. XC, No. 3 (August 1976), pp. 475-498.

Figure C1



Pure Bundling

First consider the operator's profit-maximizing behavior under a pure bundling regime. The operator gets to select the profit-maximizing price for the bundle consisting of Networks X and Y. In setting the price, the operator knows that only those consumers whose combined valuation of Network X and Network Y exceeds the price set will purchase the bundle. Under the assumptions of this model, the profit-maximizing price is approximately $0.82.[25] The profit-maximizing equilibrium is depicted in Figure C2. Consumers in region A value the bundle at less than $0.82 and do not purchase it. In contrast, consumers in region B value the bundle at more than $0.82 and subscribe.[26] Table C1 summarizes various characteristics of the pure bundling equilibrium.

---

25 Throughout this appendix, all numerical values in the text will be rounded to 2 decimal places and numerical values in tables will be rounded to 4 decimal places.

26 Consumers on the line value the bundle at exactly $0.82 and are indifferent about subscribing.

Exhibit 2

THE FAIR MARKET VALUE

OF LOCAL CABLE RETRANSMISSION RIGHTS

FOR SELECTED ABC OWNED STATIONS

BY

MICHAEL G. BAUMANN

AND

KENT W MIKKELSEN

JULY 15, 2004

ECONOMISTS INCORPORATED

WASHINGTON DC

EXECUTIVE SUMMARY

The analysis examines the fair market value of local cable retransmission rights for ABC owned broadcast television station signals in three DMAs—Philadelphia, Flint, and Toledo.[1] (These stations will be referred to individually as an "ABC Owned Station" and collectively as the "ABC Owned Stations.") The analysis is based on three benchmarks. The first benchmark begins with an estimate of the retail price charged for the ABC Owned Station signals by DirecTV and DISH Network and works back to a corresponding license fee. The second benchmark begins with an estimate of what a local cable operator in each area charges its subscribers for the ABC Owned Station signal, and works back to a corresponding license fee. The third benchmark starts with an econometric analysis of the relationship between the license fees of basic cable networks and what those networks spend on programming, and then estimates the license fees that the ABC Owned Station signals would have commanded, given ABC's expenditures on programming, had they been basic cable networks. Using the average of the estimates produced by the benchmarks in each market, the fair market value of the retransmission right for the ABC Owned Station signals in the markets considered ranges from $2.00 to $2.09 per subscriber per month.

[1] These markets were selected for analysis by ABC. The three markets include one large market, Philadelphia, and the two smallest markets in which ABC owns stations.

INTRODUCTION

Local broadcast stations, especially network affiliates, are an important part of the services provided by cable systems. Indeed, cable television got its start more than 50 years ago by offering improved reception of local broadcast station signals. Although cable systems now offer many other services, local broadcast station signals remain a key source of consumer demand for cable. This is not surprising. Local broadcast stations carry popular local news, weather and sports programming. Also, the national network entertainment, news and sports programming carried by network affiliates remains among the most popular programming on television. Actual and potential cable subscribers place a high value on this programming.

Cable carriage of local broadcast station signals produces revenues for cable operators. A cable operator may charge a higher subscription price for a package of programming networks if local broadcast station signals are included in the package. Alternatively, at any given subscription price, there will be more subscribers and more subscription revenue if local broadcast station signals are carried. Further, having more subscribers means that the cable operator can generate more revenue from the sale of local advertising and other services. In these respects, local broadcast station signals play a role similar to popular cable networks and other sources of cable content.

In order to generate subscriber and advertiser revenues, cable operators distribute cable networks, such as A&E, CNN, and Discovery, to their subscribers and pay monthly per subscriber fees to cable networks for such rights. Most cable networks sell advertising spots to national advertisers, and some also provide local ad availabilities to cable operators who in turn sell such local advertising spots to local advertisers.

Federal law establishes two methods by which cable systems carry local broadcast station signals—must carry and retransmission consent. Under must carry, cable systems are not required to pay local broadcast stations for the right to distribute the local broadcast station signals that they are required by federal law to carry. However, a local broadcast station may elect to instead exercise its right to grant retransmission consent. Under retransmission consent, cable systems are not required to carry the local broadcast

station's signal, but must negotiate with the local broadcast station if they decide to carry the broadcast station's signal.

Broadcasters and cable operators negotiate retransmission consent agreements under rules established by the FCC. The outcome of such bargaining may result in a complex agreement. Cable operators often choose to provide alternative consideration such as carriage of cable networks that are affiliated with the broadcaster in lieu of cash payment. Because the details of each negotiation vary from one cable operator to another, and because the specific details of these agreements are generally confidential, a market price for retransmission consent rights is not transparent.

The Walt Disney Company requested us to examine two related questions arising from these circumstances. First, what is the relationship between a cash payment that a cable operator might pay for retransmission consent rights and the terms of alternative arrangements to which a local broadcast station owner and a cable operator might agree? As the next section explains, there are several ways that a local broadcast station owner that is affiliated with a cable network or cable networks can be compensated for retransmission consent rights. Second, since the market price for retransmission consent rights is not transparent, what is the estimated fair market price for the retransmission consent rights of the ABC Owned Station signals? By fair market price we simply mean the price that would be observed if retransmission consent rights were traded in cash-only transactions. Using only public or third-party data, we take three approaches:

- First, we observe the retail prices currently charged by DirecTV and DISH Network, two leading satellite operators, for their packages of local broadcast signals in each market, and we work backwards to estimate a license fee for the ABC Owned Station signal that is part of that package. Estimates range from $0.97 to $1.23 per subscriber per month.

- Second, we observe the retail price currently charged by a local cable operator in each of the markets for the tier of programming that includes local broadcast station signals, and we again work backwards to estimate a license

fee for the applicable ABC Owned Station signal, which is part of that tier. This estimate ranges from $1.90 to $3.06 per subscriber per month.

- Third, we observe the relationship between what cable operators in general pay in monthly per subscriber license fees for basic cable networks and the value of basic cable networks as measured by what each spends on programming. After adjusting for the ability of the cable operator to generate revenues from local ad availabilities on certain cable networks, we use the license fee/program cost relationship to estimate what the license fee would have been for the selected ABC Owned Station signals in 2003 if they were basic cable networks. That estimate is $2.27 per subscriber per month.

Taking an average of the benchmark estimates for each market yields a fair market valuation of the retransmission rights for the selected ABC Owned Station signals ranging from $2.00 to $2.09 per subscriber per month.

CASH OR CARRIAGE?

Under the retransmission consent rules, cable operators and direct broadcast satellite distributors (collectively, multichannel video programming distributors or "MVPDs") and local broadcast television stations negotiate the terms under which MVPDs will retransmit the applicable television station(s)'s signal(s). Congress created retransmission consent rights as part of the Cable Television Consumer Protection and Competition Act of 1992. When the first transactions concerning these rights were negotiated, leading cable operators insisted that they would make no cash payments to broadcasters and subsequently initiated discussions related to launching new cable networks as possible consideration for retransmission consent rights in lieu of cash payments. Eventually, agreements were reached between the broadcast networks and the major cable operators that provided for the cable operators to carry various new broadcast network-owned cable programming services in return for retransmission consent rights to local broadcast station signals. Today, cable operators carrying cable networks as consideration for retransmission consent rights is a common practice. The FCC noted this practice in a 2000 order, and also observed that the practice is presumptively lawful.[2]

According to ABC officials, ABC offers cable systems the right to retransmit the signals of its owned stations for approximately $0.70 to $0.80 per subscriber per month. Cable operators usually decline ABC's cash offer and instead negotiate a customized deal that compensates ABC while meeting the operators' particular needs. We understand that ABC is open to any options that provide ABC with fair consideration for its owned station signals, and ABC works with cable operators to determine what form that consideration may take if the cash option is not accepted by the cable operators.

To illustrate, the following are some of the alternatives ABC has used in order to address the particular circumstances of individual operators: (a) a cable operator may

---

[2] FCC, First Report and Order, In the Matter of Implementation of the Satellite Home Viewer Improvement Act of 1999 and Retransmission Consent Issues: Good Faith Negotiation and Exclusivity, CS Docket No. 99-363, released March 16, 2000, ¶ 56, point 3.

agree to launch or reposition a cable network to reach more subscribers; (b) a cable operator could extend the term of an existing cable network distribution agreement; and (c) if a cable operator faces capacity constraints in a cable system within an ABC Owned Station's DMA, the operator may agree to launch a cable network outside of the applicable DMA. From an economic perspective, the opportunity to transact in a variety of "currencies" may increase the potential gains to the two parties from a transaction, but it does not alter the parties' respective shares of the gains. Under the various options that ABC offers to cable operators, ABC simply attempts to obtain consideration comparable to the cash option.

EXECUTIVE SUMMARY

The analysis examines the fair market value of local cable retransmission rights for ABC owned broadcast television station signals in three DMAs—Philadelphia, Flint, and Toledo.[1] (These stations will be referred to individually as an "ABC Owned Station" and collectively as the "ABC Owned Stations.") The analysis is based on three benchmarks. The first benchmark begins with an estimate of the retail price charged for the ABC Owned Station signals by DirecTV and DISH Network and works back to a corresponding license fee. The second benchmark begins with an estimate of what a local cable operator in each area charges its subscribers for the ABC Owned Station signal, and works back to a corresponding license fee. The third benchmark starts with an econometric analysis of the relationship between the license fees of basic cable networks and what those networks spend on programming, and then estimates the license fees that the ABC Owned Station signals would have commanded, given ABC's expenditures on programming, had they been basic cable networks. Using the average of the estimates produced by the benchmarks in each market, the fair market value of the retransmission right for the ABC Owned Station signals in the markets considered ranges from $2.00 to $2.09 per subscriber per month.

---

[1] These markets were selected for analysis by ABC. The three markets include one large market, Philadelphia, and the two smallest markets in which ABC owns stations.

INTRODUCTION

Local broadcast stations, especially network affiliates, are an important part of the services provided by cable systems. Indeed, cable television got its start more than 50 years ago by offering improved reception of local broadcast station signals. Although cable systems now offer many other services, local broadcast station signals remain a key source of consumer demand for cable. This is not surprising. Local broadcast stations carry popular local news, weather and sports programming. Also, the national network entertainment, news and sports programming carried by network affiliates remains among the most popular programming on television. Actual and potential cable subscribers place a high value on this programming.

Cable carriage of local broadcast station signals produces revenues for cable operators. A cable operator may charge a higher subscription price for a package of programming networks if local broadcast station signals are included in the package. Alternatively, at any given subscription price, there will be more subscribers and more subscription revenue if local broadcast station signals are carried. Further, having more subscribers means that the cable operator can generate more revenue from the sale of local advertising and other services. In these respects, local broadcast station signals play a role similar to popular cable networks and other sources of cable content.

In order to generate subscriber and advertiser revenues, cable operators distribute cable networks, such as A&E, CNN, and Discovery, to their subscribers and pay monthly per subscriber fees to cable networks for such rights. Most cable networks sell advertising spots to national advertisers, and some also provide local ad availabilities to cable operators who in turn sell such local advertising spots to local advertisers.

Federal law establishes two methods by which cable systems carry local broadcast station signals—must carry and retransmission consent. Under must carry, cable systems are not required to pay local broadcast stations for the right to distribute the local broadcast station signals that they are required by federal law to carry. However, a local broadcast station may elect to instead exercise its right to grant retransmission consent. Under retransmission consent, cable systems are not required to carry the local broadcast

station's signal, but must negotiate with the local broadcast station if they decide to carry the broadcast station's signal.

Broadcasters and cable operators negotiate retransmission consent agreements under rules established by the FCC. The outcome of such bargaining may result in a complex agreement. Cable operators often choose to provide alternative consideration such as carriage of cable networks that are affiliated with the broadcaster in lieu of cash payment. Because the details of each negotiation vary from one cable operator to another, and because the specific details of these agreements are generally confidential, a market price for retransmission consent rights is not transparent.

The Walt Disney Company requested us to examine two related questions arising from these circumstances. First, what is the relationship between a cash payment that a cable operator might pay for retransmission consent rights and the terms of alternative arrangements to which a local broadcast station owner and a cable operator might agree? As the next section explains, there are several ways that a local broadcast station owner that is affiliated with a cable network or cable networks can be compensated for retransmission consent rights. Second, since the market price for retransmission consent rights is not transparent, what is the estimated fair market price for the retransmission consent rights of the ABC Owned Station signals? By fair market price we simply mean the price that would be observed if retransmission consent rights were traded in cash-only transactions. Using only public or third-party data, we take three approaches:

- First, we observe the retail prices currently charged by DirecTV and DISH Network, two leading satellite operators, for their packages of local broadcast signals in each market, and we work backwards to estimate a license fee for the ABC Owned Station signal that is part of that package. Estimates range from $0.97 to $1.23 per subscriber per month.

- Second, we observe the retail price currently charged by a local cable operator in each of the markets for the tier of programming that includes local broadcast station signals, and we again work backwards to estimate a license

fee for the applicable ABC Owned Station signal, which is part of that tier. This estimate ranges from $1.90 to $3.06 per subscriber per month.

- Third, we observe the relationship between what cable operators in general pay in monthly per subscriber license fees for basic cable networks and the value of basic cable networks as measured by what each spends on programming. After adjusting for the ability of the cable operator to generate revenues from local ad availabilities on certain cable networks, we use the license fee/program cost relationship to estimate what the license fee would have been for the selected ABC Owned Station signals in 2003 if they were basic cable networks. That estimate is $2.27 per subscriber per month.

Taking an average of the benchmark estimates for each market yields a fair market valuation of the retransmission rights for the selected ABC Owned Station signals ranging from $2.00 to $2.09 per subscriber per month.

CASH OR CARRIAGE?

Under the retransmission consent rules, cable operators and direct broadcast satellite distributors (collectively, multichannel video programming distributors or "MVPDs") and local broadcast television stations negotiate the terms under which MVPDs will retransmit the applicable television station(s)'s signal(s). Congress created retransmission consent rights as part of the Cable Television Consumer Protection and Competition Act of 1992. When the first transactions concerning these rights were negotiated, leading cable operators insisted that they would make no cash payments to broadcasters and subsequently initiated discussions related to launching new cable networks as possible consideration for retransmission consent rights in lieu of cash payments. Eventually, agreements were reached between the broadcast networks and the major cable operators that provided for the cable operators to carry various new broadcast network-owned cable programming services in return for retransmission consent rights to local broadcast station signals. Today, cable operators carrying cable networks as consideration for retransmission consent rights is a common practice. The FCC noted this practice in a 2000 order, and also observed that the practice is presumptively lawful.[2]

According to ABC officials, ABC offers cable systems the right to retransmit the signals of its owned stations for approximately $0.70 to $0.80 per subscriber per month. Cable operators usually decline ABC's cash offer and instead negotiate a customized deal that compensates ABC while meeting the operators' particular needs. We understand that ABC is open to any options that provide ABC with fair consideration for its owned station signals, and ABC works with cable operators to determine what form that consideration may take if the cash option is not accepted by the cable operators.

To illustrate, the following are some of the alternatives ABC has used in order to address the particular circumstances of individual operators: (a) a cable operator may

---

[2] FCC, First Report and Order, In the Matter of Implementation of the Satellite Home Viewer Improvement Act of 1999 and Retransmission Consent Issues: Good Faith Negotiation and Exclusivity, CS Docket No. 99-363, released March 16, 2000, ¶ 56, point 3.

agree to launch or reposition a cable network to reach more subscribers; (b) a cable operator could extend the term of an existing cable network distribution agreement; and (c) if a cable operator faces capacity constraints in a cable system within an ABC Owned Station's DMA, the operator may agree to launch a cable network outside of the applicable DMA. From an economic perspective, the opportunity to transact in a variety of "currencies" may increase the potential gains to the two parties from a transaction, but it does not alter the parties' respective shares of the gains. Under the various options that ABC offers to cable operators, ABC simply attempts to obtain consideration comparable to the cash option.

ESTIMATED FAIR MARKET PRICE

Using DirecTV and DISH Network prices as a benchmark

DirecTV and DISH Network are the two major direct broadcast satellite (DBS) providers in the United States, with a current combined total of over twenty million subscribers. Legislation enacted in 1999 gave DirecTV and DISH Network the right to carry local broadcast stations. Both companies compete with cable television operators for subscribers, and both carry many of the same networks as cable systems. We therefore assume that DirecTV and DISH Network subscribers are representative of cable subscribers in their valuation of local broadcast signals, and that the relationship between wholesale and retail prices for such programming on DirecTV and DISH Network is indicative of the corresponding relationship for cable systems, and vice versa.

Any subscriber to DirecTV in a market where DirecTV provides local signals can add a package of local broadcast channels for $6.00 per month.[3] DirecTV currently offers such local programming in Philadelphia and Flint.[4] A subscriber to DISH Network in those markets with a local signal package can add the package for $5.99 per month. DISH Network also currently offers a local programming package in Philadelphia and Flint. Given the competitive importance to DBS services of offering local channels, DBS providers may provide these packages at reduced rates to spur subscribership.[5] If so, our estimates based on this benchmark will understate the fair market value of retransmission rights.

---

[3] Beginning in March 2004, if a subscriber purchases a DirecTV package with local channels, the subscriber gets a $3 bundling discount. But if the subscriber only had Select Choice or some kind of special package or a complimentary package, and wanted to add the local channels, then the additional cost would be $6. See copy of a June 2004 DirecTV monthly statement attached as Appendix A.

[4] DirecTV plans to begin offering local signals in Toledo in 2004.

[5] The FCC noted that the growth in DBS subscribers is, in part, attributable to the authority granted to them to distribute local broadcast television stations. FCC, *Tenth Annual Report: Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket 03-172, ¶¶8, 65.

In each market, both the DirecTV and DISH Network packages include programming from several local stations. It is unlikely, however, that the signals have equal value, either to subscribers or to DirecTV or DISH Network in attracting subscribers. For purposes of our analysis we assume that the value of the stations included in either the DirecTV or DISH Network local package is proportional to the stations' shares of local audience.[6] Using data from the May 2004 sweeps, we determine the total day viewing share of each programming service included in each market's local channel package.[7] We then compute each ABC Owned Station signal's share of viewing relative to all services in the package.

We attribute to each ABC Owned Station signal a percentage of the retail value of the local channel package based on its relative share of viewing of services in the package. The results are presented in Table 1. The implied retail value for an ABC Owned Station signal ranges from $1.64 to $2.08 based on the DISH Network price and from $1.65 to $2.09 based on the DirecTV price.

Table 1: Estimated retail value of ABC Owned Station signals based on DBS fees

	DISH Network ($5.99/mo.)		**DirecTV ($6.00/mo.)**	
Market	ABC Owned Station Viewing Share	Attributed Value	ABC Owned Station Viewing Share	Attributed Value
Flint	34.8%	$2.08	34.8%	$2.09
Philadelphia	27.5%	$1.64	27.5%	$1.65
Toledo	n.a.	n.a.	n.a.	n.a.

To derive an estimate of market value for local broadcast retransmission rights, we need to translate this retail value into a corresponding wholesale value or license fee.

---

[6] Viewers' demand or willingness to pay for programming is not the same as ratings or viewing shares. In theory, programming with a relatively small audience that is intensely interested may command higher revenue than programming that attracts a larger but less interested audience. Lacking direct measures of viewer willingness to pay for individual broadcast networks, we use ratings and viewing shares as an approximation.

[7] Underlying data are from Nielsen.

To do this, we make use of the relationship between wholesale license fees and subscriber prices observed for other programming. In 2002, wholesale revenue for premium services was about 59 percent of retail revenue for such services.[8] Applying this percentage implies that the wholesale value to ABC Owned Station signals would range from $0.97 to $1.23, based on both the DISH Network prices and the DirecTV prices. See Table 2. This percentage is equivalent to a retail markup over wholesale of about 70 percent. Since DBS providers would likely apply a very low or no markup to the license fee given the competitive importance of local signals to DBS services, as noted above, the actual retail markup may well be lower than 70 percent and therefore the wholesale values are likely to be higher than estimated here.

Table 2: Estimated wholesale value of ABC Owned Station signals based on DBS fees

Market	DISH Network	DirecTV
Flint	$1.23	$1.23
Philadelphia	$0.97	$0.97
Toledo	n.a.	n.a.

Using the local cable operator's basic tier price as a benchmark

Our second approach to estimating a fair market value for retransmission of the ABC Owned Station signals is to look at the retail price a local cable operator charges for the service tier that includes the ABC broadcast station and then work backwards to an implied wholesale value.[9]

Most cable operators provide a Basic Service Tier that functions primarily as a "reception" package. The tier is typically composed of local broadcast television stations and government access channels. Most likely, as with the satellite local signal packages, this price is below fair market value. Although some cable television prices have recently

---

[8] Kagan World Media, *The Pay TV Newsletter*, July 31, 2002, p. 3. Kagan estimated that the wholesale percentage of retail revenue was 59.1 percent in 2002 and would be about 59.5 percent in 2004.

[9] The cable operators selected were identified as serving the named city.

been deregulated at the federal level, basic tier prices remain regulated by state and local authorities. Such tiers are often offered at a discount for regulatory or public relations reasons, to satisfy agreements with local agencies or to improve relations with the FCC or franchise authorities. Historically, few cable subscribers opt for only this basic service. Therefore, cable operators lose little by offering a low price. Nevertheless, we assume that the Basic Service Tier price reflects market value. If the retail price is below fair market value, our estimate of the corresponding wholesale price again understates the fair market value of retransmission rights.

We again assume that the value attributable to an individual channel on this tier is proportional to its ratings relative to all the channels on the tier.[10] See Table 3.

Table 3: Estimated value of ABC Owned Station signals based on cable operator fees

Market	Operator	Rate	Number of Channels	ABC Owned Station Viewing Share	Attributed Retail Value	Estimated Wholesale Value
Flint	Comcast	$12.75	19	33.3%	$4.25	$2.51
Philadelphia (19132)	Comcast	$15.60	32	27.5%	$4.28	$2.53
Philadelphia (19102)	Comcast	$20.00	34	25.9%	$5.19	$3.06
Toledo	Buckeye	$12.15	19	26.5%	$3.22	$1.90

Based on the relative share of viewing in each market, approximately 20 percent to 30 percent of the value of the basic service tier is attributable to the ABC Owned Station signal. The retail value attributed to the ABC Owned Station signals ranges from $3.22 to $5.19. We again assume that the wholesale value is 59 percent of the retail value. This implies a wholesale value, or retransmission license fee, ranging from $1.90 to $3.06 for the ABC Owned Station signals.

---

[10] See note 6. Many services on the basic service tier have no ratings reported by Nielsen. The absence of ratings data generally implies that the audiences are too small to be measured accurately. We assumed that these services had a zero share.

Using cable network license fees as a benchmark

Our third approach to the question of estimating the fair market value of local cable retransmission rights to the ABC Owned Station signals relies on what cable operators pay for various cable networks. The economic foundation of basic cable networks is the cable operators' ability to distribute cable networks to viewers for monthly subscription fees as well as to deliver audiences to advertisers. Cable operators pay license fees to distribute cable networks, such as ESPN or CNN. These license fees (wholesale prices) are determined by free market competition.

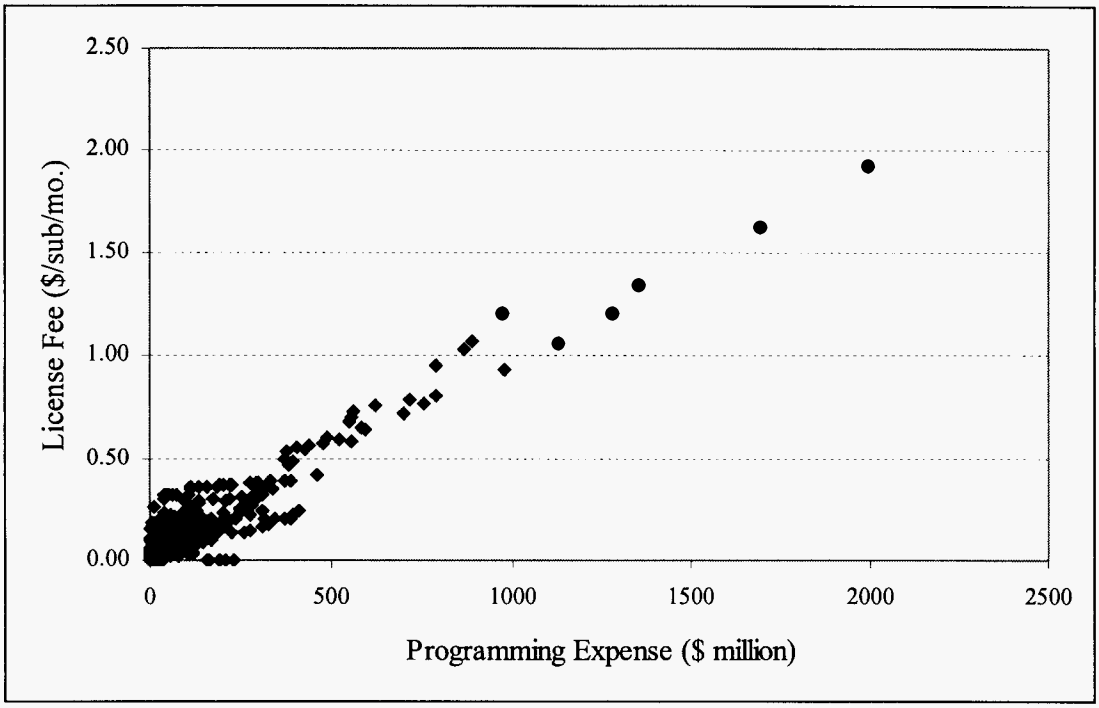
There is a strong correlation between the license fees paid by cable operators to cable networks and the level of programming expenditure by those cable networks. See Figure 1.[11] It is not surprising to find that more popular, expensively-produced cable networks have higher license fees than do less popular cable networks. We rely on this relationship between cable network programming expense and cable network license fees to project the value of broadcast station signal retransmission consent rights based on broadcast network programming expenses.[12]

---

[11] Data from Kagan Research, *Economics of Basic Cable Networks 2005: Key Spreadsheets*, June 2004. Programming expenses and license fees expressed in real 2003 dollars using the GDP implicit price deflator.

[12] The fee cable operators (and ultimately, viewers) are willing to pay for a program service depends on the quality or attractiveness of the programming provided. Higher perceived programming quality, in turn, is directly related to programming expense. This is so because competition among distributors drives up the prices of the most attractive program services. Therefore, one would expect that license fees per subscriber would increase as programming expenditures increase, other things equal. See B. Owen and S. Wildman, *Video Economics*, 144-150 (1992); B. Litman, *Predicting Success of Theatrical Movies: An Empirical Study,* 16 Journal of Popular Culture 159 (1983); and M. Blumenthal, *Auctions with Constrained Information: Blind Bidding for Motion Pictures*, 70 Review of Economics and Statistics 191 (1988).

Figure 1: Cable network license fees versus programming expenses, 1992-2003
(in real 2003 dollars)



Although very important, program expense is not the only factor that explains the license fees commanded by cable networks. Many cable networks receive not just license fees from cable operators but also advertising revenues from national advertisers. Each cable network must decide how to trade off these two sources of revenue. Other things being equal, if a cable network's per subscriber wholesale license fee is lower, cable operators will provide it to more subscribers than more expensive cable networks. Such more widely distributed cable networks will accordingly be more attractive to advertisers and could result in greater advertising revenue. This tradeoff has become more important as the cable advertising marketplace has grown in the last decade. Our analysis takes this tradeoff into account.

A related issue in understanding cable network license fees is the availability of local advertising spots. A cable operator will be willing to pay more, other things being equal, for a cable network that provides opportunities for the cable operator to sell local advertising spots. In doing this, of course, the cable network gives up the opportunity to

sell such spots to national advertisers. Because local cable advertising has grown in importance, this effect must now also be taken into account for purposes of estimating the fair market value of broadcast retransmission rights.

Kagan Research's publication *Economics of Basic Cable Networks 2005* provides data regarding basic cable networks.[13] For purposes of our analysis, we use data on 94 cable networks for 12 years (not all cable networks were in operation in every year), as depicted in Figure 1.[14] We adjust these data for inflation and then use an econometric technique (regression analysis) to estimate the overall average relationship between license fees and programming expenditures. See Appendix B. We apply the resulting relationship to programming expenditures by the ABC network in 2003 as reported by Kagan Research.[15] The result is an imputed monthly license fee that the ABC network could command as a basic cable network.[16] That number is $3.00 per subscriber per month.

As indicated above, economic analysis of the cable industry suggests that we should also take into account the growing importance of cable advertising revenue. In theory, this should tend to reduce license fees. We account for this by including for each cable network an estimate of its advertising revenue in each year. The result is that the imputed monthly license fee for the ABC network drops to $2.81 for the year 2003.

---

13 The FCC regularly relies on the industry statistics and projections by Kagan Research in its rulemaking decisions and analyses of the video industry. See, e.g., FCC, *Tenth Annual Report*, Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, MB-Docket 03-172.

14 The *Economics of Basic Cable Networks 2005* lists subscriber, license fee and programming expense data for 120 cable networks. For various reasons, 26 networks were excluded from the analysis—8 had data starting only in 2004; 9 had only one year of usable data; 3 were premium networks for part of the time period; 5 were Spanish language; and 1 was a delayed feed of another.

15 Kagan Research, "Broadcast Network Economics, 2001-2003," *TV Program Investor*, May 27, 2004.

16 The prediction relates to the average fee paid by all cable operators. To apply this methodology to an individual cable operator we would need to know that operator's license fees for the cable networks it carries and that operator's local advertising revenues per network.

As explained above, cable operators derive local advertising revenue from some cable networks. Broadcast station signals do not afford such an opportunity, and other things being equal this reduces the value of broadcast station signals to cable operators relative to cable networks that offer local advertising availabilities. To account for the value of local advertising availabilities to cable operators, we include a variable that measures the value of local cable advertising attributable to each cable network. The effect of this adjustment is to reduce the imputed value of the ABC network monthly license fee to $2.27 per subscriber.

The preceding analysis may understate the value of the ABC Owned Station signals because it does not take into account the value of local and other non-network programming. Our evaluation of the ABC network if it were a basic cable channel omits any consideration of the local content of the ABC stations' signals. The cable networks used to estimate the value of ABC retransmission rights generally do not offer local content. If it were possible to take this into account it would likely increase the license fee that an ABC Owned Station signal could command above the value associated with the ABC network programming.

CONCLUSION

Table 4 summarizes the estimated values of the ABC Owned Station signals from each of the three methods.

Table 4: Summary of retransmission value estimates

Market	DBS	Cable	Regression	Average
Flint	$1.23, $1.23	$2.51	$2.27	$2.00
Philadelphia	$0.97, $0.97	$2.53, $3.06	$2.27	$2.01
Toledo	n.a.	$1.90	$2.27	$2.09

If we give the average value of each method's estimate obtained within a market equal weight, we obtain the average valuation reported in the last column of Table 4. Using these averages, the fair market value of the retransmission right for the ABC Owned Station signals in the markets considered ranges from $2.00 to $2.09 per subscriber per month.

Appendix A: Sample DirecTV Monthly Statement

View Statements
Payment History

Customer Profile
Payment Profile
Terms and Conditions
Logout

Monthly Statement

Billing Address
[redacted]
N
HERMOSA BEACH, CA
90254[redacted]
[redacted]

Service Address:
[redacted]
HERMOSA BEACH, CA
90254[redacted]

DIRECTV

Date Due	Account Number	Amount Due
Not Due	013937664	No payment due

Bill Statement Date		
06/09/2004	Previous Balance	0.00
	(-) Payments and credits	15.98
	(+) Current charges and taxes	15.98
	= AMOUNT DUE	$0.00

Access Card	Start	End	Description	Amount
			Previous Balance	0.00
	06/09/04		Payment - Thank You - VISA	- 15.98
1405-353192			***Subscriptions***	
	06/08/04	07/07/04	Premier Bonus: You Save $4.99 DIRECTV DVR	0.00
	06/08/04	07/07/04	Complimentary TOTAL CHOICE PREMIER	0.00
	06/08/04	07/07/04	Monthly Your Local Channels	6.00
1382-142063			***Subscriptions***	
	06/09/04		Additional Receiver	4.99
1390-093225			***Subscriptions***	
	06/09/04		Additional Receiver	4.99
			AMOUNT DUE	**$0.00**

Appendix B: A statistical model of television network license fees

The fees MVPDs (and ultimately, viewers) are willing to pay for programs depend on the quality of the programs provided. Higher perceived program quality, in turn, is directly related to program expense. Therefore, one would expect that license fees per subscriber would increase as program expenditure increases.[17]

An appropriate statistical model relates cable network license fees to their main determinants, program expenditures and network advertising revenues. Once this relationship is estimated, the estimated model predicts a fair market value fee for the broadcast networks. The general form of the statistical model is as follows:

$$\text{Fee}_{it} = \beta_0 + \beta_1 \bullet \text{Program Expense}_{it} + \beta_2 \bullet \text{Advertising Revenue}_{it}$$
$$+ \beta_t \bullet \text{Year Dummy} + \varepsilon_{it}$$

where Fee is the average per-subscriber per-month licensing fee, Program Expense is the annual program expenditure, Advertising Revenue is the annual net advertising revenue, ε is a statistical error term, subscript i indicates network i, and subscript t indicates year t. The model allows for individual year-specific effects, β_t.

Two changes were made to this general form for the final version of the regression. First, since the license fee may depend on the ability of the cable operator to insert local advertising, a variable was included to account for local cable advertising revenue attributable to each network.[18] In addition, the intercept term, β_0, is allowed to

---

[17] Data on license fees, program expenditures and the number of subscribers for 94 basic cable networks are obtained from Kagan Research, *Economics of Basic Cable Networks 2005: Key Spreadsheets,* June 2004. While Kagan provides data for 120 cable networks, 26 networks were excluded from the analysis. See footnote 13.

[18] Total local cable advertising revenue is from Paul Kagan Associates, *The Kagan Media Index*, September 30, 2000, and *Kagan Media Money*, August 29, 2003. The percentage of local ad revenue attributable to each cable network is from "Average Share of Local Cable Ad Revenue by Network," Paul Kagan Associates, *Broadband Advertising,* December 13, 2001. Data on the share of local cable ad revenue were available only through 2000. Shares for 2001, 2002, and 2003 are assumed to be the same as in 2000.

vary by network, using the assumption that the intercept will be a function of the average program expenditure of the network over the observed period.

The equation estimated is

$$\text{Fee}_{it} = \beta_0 \bullet \text{Average Program Expense}_i + \beta_1 \bullet \text{Program Expense}_{it}$$
$$+ \beta_2 \bullet \text{Advertising Revenue}_{it} + \beta_3 \bullet \text{Local Advertising Revenue}_{it}$$
$$+ \beta_t \bullet \text{Year Dummy} + \varepsilon_{it}$$

where Average Program Expense is the average program expense over the period for which there exist data for the network and Local Advertising Revenue is the average per-subscriber per-month local advertising revenue.

All variables are expressed in real 2003 dollars, using the GDP implicit price deflator. Standard (OLS) estimation of the model produces the following results:[19]

Model estimation results

F:	431.4	Pr > F:	<.0001	
R^2:	0.9007	Root MSE:	0.0574	
Parameter	Estimate	T-value for H_0:Parameter=0	Pr > |T|	Std. Error of Estimate
β_0	0.0001765	4.74	<.0001	0.0000372
β_1	0.0009072	26.55	<.0001	0.0000342
β_2	–0.0003077	–12.35	<.0001	0.0000249
β_3	0.3718	8.57	<.0001	0.04341
β_{2003}	0.05161	8.34	<.0001	0.00619

[19] The last term in the model is an error term, which is the difference between the predicted results and the actual observation. OLS, ordinary least squares, is a procedure that minimizes the sum of the squares of the error terms—hence, the phrase "least squares." The OLS estimator is a standard statistical procedure that gives the best, straight-line, unbiased estimate of the relationship between the variables.

From the model results, it is possible to construct an equation that estimates the free market value of retransmission of the ABC Owned Station signals. For the program expense of the ABC Owned Stations we use the program expense of the ABC network. This is conservative since it ignores both expenditures on and the nature of local news, local sports, other locally originated programming and syndicated programming on the stations. ABC's programming expenditure for 2003 was $3,010 million and its net advertising revenue in 2003 was $3,169 million.[20] ABC's average annual real programming expenditure from 1992 through 2003 was $2,624.9 million.[21] Using these values gives an estimated license fee of $2.27 per subscriber per month.[22]

---

20 "Broadcast Network Economics, 2001-2003," Kagan Research, *TV Program Investor*, May 27, 2004.

21 "Broadcast Network Economics, 1991-1993," Paul Kagan Associates, *TV Program Investor*, February 28, 1994; "Broadcast Network Economics, 1993-1998," Paul Kagan Associates, *TV Program Investor*, April 15, 1999; "Broadcast Network Economics, 1997-1999," Paul Kagan Associates, *TV Program Investor*, April 20, 2000; "Broadcast Network Economics, 2000-2002," Kagan World Media, *TV Program Investor*, June 26, 2003; "Broadcast Network Economics, 2001-2003," Kagan Research, *TV Program Investor*, May 27, 2004.

22 The 95 percent confidence interval on this estimate is plus or minus 19¢.

Exhibit 3

Carat USA
2450 Colorado Avenue, Suite 300 East, Santa Monica, CA 90404, USA
Tel +(1) 310 255 1000 Fax +(1) 310 255 1050
www.carat.com

FAX: 202.222.4799
Re: Charlie Rutman position on A La Carte Cable July 7, 2004

My name is Charlie Rutman and I currently serve as President of Carat USA. I have been in this job for 6 ½ years and have been involved in the advertising / media sector for 28 years, specifically advising on advertising purchases.

In my view, if distribution of certain cable channels becomes limited, their national ratings are likely to decline in accordance with the drop in distribution. In my experience, national-distributed clients are interested in achieving the highest national reach and the highest national ratings on a given network. If the distribution of a channel were to be severely cut, ad spending would most likely be cut in accordance with those drops and some networks would drop off buy lists. This would have two effects. First, because there would be fewer places for national advertisers to buy, competition on the "buy side" of advertising would decrease. Second, and perhaps more importantly, it would particularly hard for new networks to be launched.

These statements reflect my own opinions and do not necessarily reflect the opinion of Carat USA. They are made for no purpose other than to provide insight for the FCC's consideration of various a la carte questions on which the FCC has requested public comment.

Sincerely,

Charlie Rutman
President
Carat USA

Exhibit 4

Tim Spengler
Executive Vice President
Director, National Broadcast

E tim.spengler@us.initiativemedia.com

Initiative One Dag Hammarskjold Plaza
New York NY 10017

T 212 605 7322
F 212 605 7822

initiative

7 July 2004

Susan Fox
Vice President, Government Relations
The Walt Disney Company
1150 17th Street, N.W., Suite 400
Washington, DC 20036

Dear Susan,

My name is Tim Spengler and I currently serve as Executive Vice President for National Broadcast for Initiative Media. I have been in this job for five years and have been involved in advertising and, specifically, advising on advertising purchases for 19 years.

In my opinion, nationally distributed clients are interested in achieving the highest national reach as well as the highest national ratings on a given network. Currently, because of the wide distribution of many cable channels, national advertisers have a variety of channels on which to buy advertising. If distribution of a cable channel were to become limited, national advertisers would most likely cut spending in accordance with these drops. In my view, the result would be that some networks would drop off buy lists.

These statements reflect my own opinions and are made for no purpose other than to provide insight for the FCC's consideration of various a la carte questions on which the FCC has requested public comment.

Feel free to call if you would like to discuss this matter in greater detail.

Best regards,

Exhibit 5

mediaedge:cia

July 1, 2004

Ms. Susan Fox
Vice President, Government Relations
Walt Disney
1150 17th Street, Suite 400
Washington, D.C. 20036

Dear Susan:

My name is Denise Weimann and I currently serve as Managing Partner for National Television Buying for Mediaedge:cia. I have been in this job for 6 years and have been involved in advertising and, specifically, advising clients on advertising purchases for 25 years.

One of the main focuses of my job is that I am responsible for the cable advertising purchasing for a major national franchisor. There are some unique considerations when purchasing advertising for a national franchisor. Because the advertising is funded by *local* franchisees, it is *critical* that the cable channels on which a franchisor buys advertising are distributed as widely as possibly and ideally in all the locations where local franchisees are located. This is a separate consideration from the aggregate national rating or share for any given channel or program because local franchisees want the advertising to reach viewers in their local area and a highly-watched program in one area of the country (e.g., in NY or Washington) is not of interest to them if the program is not even received by viewers in their franchise area (e.g., in Omaha). Examples of national franchisors that purchase a significant amount of advertising are quick serve restaurants, beverage companies, and car dealers.

As a general matter, in my experience nationally distributed clients are interested in achieving the highest national reach and the highest national ratings on a given network. In the early years of cable, some national advertisers had absolute requirements that they would only purchase advertising on channels with a certain level of national penetration. Since cable hit the 50-60% national penetration mark, national advertisers have had more flexibility and more options because they have been able to select from a wide variety of cable channels with wide national reach. If distribution were to be severely limited, I believe that national advertisers would most likely cut spending on those networks. Those networks would likely drop off the buy list (as in the early years of cable).

These statements reflect my own opinions and are made for no purpose other than to provide insight for the FCC's consideration of various a la carte questions on which the FCC has requested public comment.

Denise Weimann

Denise Weimann
Managing Partner, National Broadcast Director
Mediaedge:cia 825 Seventh Avenue New York NY 10019 USA
Tel +1 212 474 0673 Fax +1 212 474 0001

Exhibit 6

To Whom It May Concern: July 7, 2004

My name is Tom Winner. I am the Global Media Buying Director for Wieden + Kennedy Advertising. I have been in the media buying business for thirty years, and currently handle clients such as NIKE, jetBlue, and Avon. In the past, I have placed advertising for such brands as Microsoft, Mastercard, Colgate, Nissan, Ralston Purina, Everyready Batteries, and Anheuser Busch.

Wieden+Kennedy

150 Varick Street
Seventh Floor
New York
New York 10013
USA

Telephone
917 661 5200

Facsimile
917 661 5500

During this tenure, I have watched the development of cable television from a means to bring signals across mountains to a driving force in the broadcasting business. I am convinced that the growth of this medium is due to the bundling of disparate networks under a single pricing umbrella. This technique enabled viewers to sample a variety of networks which not only made the medium robust, but allowed small networks gain viewers and grow into profitable entities.

I fear that ala carte pricing being proposed by some legislators today will stymie further growth of this medium. An obvious issue would be the reduction in variety of program offerings. Another would be the resultant cost/benefit ratio. I find it difficult to believe that cable systems would be able to generate required revenue through the ala carte pricing method. My belief is they will only be able to exist by charging exorbitant ala carte prices for each network.

These are issues of great concern to all of us in the marketing business. We are all dependent on mass media like television to deliver our informational messages to prospective consumers. Ala carte pricing for cable will dramatically lessen the potential reach of every network. For instance, using ESPN as an example, weekly

viewership is approximately 30MM. Quarterly viewership is 60MM. Most of the difference is made up of casual, non-core viewers. Ala carte pricing will virtually eliminate this difference, making ESPN a much less attractive media vehicle for advertisers.

By instituting ala carte pricing, legislators will be interfering with natural marketplace forces. To do this is to court disaster. Viewers will miss the variety of programming currently available. They will be upset by having to pay big numbers for their favorite networks. New and small networks will lie moribund, unable to be sampled or to grow. Advertisers will be hard pressed to find another means to effectively reach their target consumers. Cable systems will be forced to reduce their new technology offerings due to lower subscription revenue from viewers.

I would ask that you consider leaving well enough alone, and don't take the chance of lousing up a system that, although not perfect, nes very close to delivering the greatest amount of good to the greatest number of people.

Thank you for you consideration.

Cordially,

Thomas H. Winner
Global Media Buying Director

Exhibit 7

CITY of LAS VEGAS

August 27, 1992

Harris H. Bass
Vice President & General Manager
Prime Cable
900 S. Commerce
Las Vegas, NV 89106

Dear Mr. Bass:

Please accept our compliments on your recent decision to add the Disney channel to your basic cable package, while also eliminating the remote control charge to senior citizens. This latest addition to your services is yet another example of the community-oriented decisions made by Prime Cable as you plan for your company's future in the Las Vegas valley.

The City of Las Vegas has reviewed this, as well as other, program product decisions made by your company, and we consistently find your concern for first-rate customer service standards to be a hallmark of Prime Cable.

We at the City look forward to hearing many more success stories from your company.

Sincerely,

William J. Noonan

William J. Noonan
City Manager

WJN:ks

cc: Mayor Jan Laverty Jones
Councilman Bob Nolen
Councilman Arnie Adamsen
Councilman Scott Higginson
Councilman Frank Hawkins Jr.

Prime Cable - Las Vegas
- Letter from City Manager
- Proclamation

Copy of Disney Channel Day declaration for Las Vegas, NV.

DISNEY CHANNEL DAY

WHEREAS; the City of Las Vegas is proud to designate Wednesday, October 21, 1992 as DISNEY CHANNEL DAY; and

WHEREAS; the Disney Channel provides entertainment the entire family can enjoy together and spectacular television productions that delight people of all ages; and

WHEREAS; the Disney Channel gives the audiences an opportunity to see such a multitude of Disney stars, old favorites and hot new personalities. Many of the programs provide excellent educational, enrichment-type shows while informing and enhancing the lives of our young people; and

WHEREAS; it is indeed an honor to pay special tribute to the Disney Channel for their outstanding programming and for helping to bring high quality shows to children and adults around the world.

NOW, THEREFORE, WE, the undersigned Mayor and City Councilmen do hereby proclaim Wednesday, October 21, 1992 to be:

DISNEY CHANNEL DAY

in the City of Las Vegas and urge all citizens to join with us in honoring the Disney Channel for their superior programming. Congratulations and best wishes for continued success and prosperity.

JAN LAVERTY JONES, Mayor

BOB NOLEN, City Councilman

ARNIE ADAMSEN, City Councilman

SCOTT HIGGINSON, City Councilman

FRANK HAWKINS JR., City Councilman

Exhibit 8

OFFICE OF THE MAYOR
CITY AND COUNTY OF HONOLULU
HONOLULU, HAWAII 96813 • AREA CODE 808 • 523-4141

JEREMY HARRIS
MAYOR

November 28, 1995

Mr. Benjamin N. Pyne
Vice President, Western Region
The Disney Channel
3800 West Alameda Avenue, Suite 310
Burbank, Ca. 91505

Dear Mr. Pyne:

It was my pleasure to assist you with the "arrival" of Mickey Mouse to Waikiki beach. Ramona and I enjoyed our part in officially launching the Disney Channel on the Oceanic Cable station.

Thank you for sending the sericel and the photo.

Please do not hesitate to contact the Office of the Mayor if we can be of assistance to you again.

Sincerely,

JEREMY HARRIS
Mayor

JH:lc

Oceanic Honolulu, HI
- Letter from Mayor
- Proclamation

OFFICE OF THE MAYOR

CITY AND COUNTY OF HONOLULU

PROCLAMATION

It is my great pleasure to offer warm greetings of aloha to Mickey Mouse on the occasion of Oceanic Cablevision bringing The Disney Channel into all of its basic subscribers' homes on Oahu starting September 30, 1995.

At a time when we are besieged from all sides by unsavory images and content on television, The Disney Channel offers wholesome entertainment for the entire family.

Mickey Mouse is known throughout the world as the symbol of Disney. It is an honor to welcome him to Honolulu and The Disney Channel to Oceanic subscribers without additional charge.

NOW, THEREFORE, I, JEREMY HARRIS, Mayor of the City and County of Honolulu, do hereby proclaim September 29, 1995, as

THE DISNEY CHANNEL DAY

in the City and County of Honolulu and extend appreciation to Disney for its charitable work and for providing Oahu residents with fine entertainment.

IN WITNESS WHEREOF, I have hereunto set my hand and caused the Seal of the City and County of Honolulu to be affixed.

Done at Honolulu, Hawaii, this 29th day of September, 1995.

JEREMY HARRIS, Mayor
City and County of Honolulu

Exhibit 9

CTV Specialty
CTV Specialty Television Inc.

9 Channel Nine Court
Scarborough, Ontario
Canada M1S 4B5

Tel 416.332.5000
Fax 416.332.4688

www.ctv.ca

Mr. Ed Durso
Executive Vice President, Administration
ESPN, Inc.
77 West 66th Street
New York, NY 10023

Dear Mr. Durso:

Re: Canadian Broadcasting System

You have requested that I provide you with some insight into the Canadian broadcasting system ("the Canadian System") with specific focus on whether the offering of specialty programming services on an "a la carte" basis is either prevalent or successful in Canada.

Background: Personal and Company

1. I am Executive Vice President of CTV Specialty Television Inc. I oversee the administration and operation of the CTV Specialty Group, which manages one of the largest and most successful stables of specialty services in Canada. These services include The Sports Network ("TSN"), Le Réseau des Sports (RDS"), Discovery Channel, ESPN Classic Canada, NHL Network, Discovery Civilization and Animal Planet.
2. Specialty services in Canada are analogous to cable networks in the United States.
3. CTV Specialty Television Inc. is owned and controlled by CTV Inc. ("CTV"). ESPN, Inc. is an approximately 30% minority shareholder in CTV Specialty Television Inc. In addition to its interest in a variety of specialty services, CTV is a leader in over the air broadcasting in Canada with twenty-one television stations across the country. CTV's over the air stations cover ninety-nine percent of English-speaking households, offering a wide range of quality news, sports, information and entertainment programming. CTV is owned by Bell Globemedia Inc., which also owns The Globe and Mail, a national newspaper publication.

Background: Canadian Broadcasting System

4. The Canadian System is regulated through the Canadian Radio-television and Telecommunications Commission (the "CRTC"). The CRTC is an independent public authority that reports to the Canadian Parliament through the Minister of Canadian Heritage.
5. The CRTC has the authority to regulate and supervise all aspects of the Canadian System, as well as to regulate telecommunications common carriers that fall under Federal jurisdiction.
6. With respect to specialty services in Canada, the two primary aspects of the Canadian System are the licensing of specialty services and distribution of same to consumers. The CRTC regulates both aspects of specialty television.

Specialty Service Broadcast Licences

7. There are generally three types of specialty service licences in Canada: analogue, Category 1 digital and Category 2 digital.

(a) Analogue Licences

8. Analogue specialty services represent the first wave of specialty services licensed by the CRTC between 1984 and 1996 when the primary mode of program distribution was via analogue cable systems. These specialty services have achieved high levels of penetration across the installed analogue cable base. For example, TSN's penetration of cable/DTH households is approximately 80%.
9. Analogue broadcast licence conditions reflect the expectations of high penetration and typically include:
    - restrictions on allowable program genres;
    - minimum levels of Canadian programming (hours);
    - minimum levels of Canadian program expenditures; and
    - a regulated wholesale rate when distributed on basic cable.

Wholesale rates are negotiated between programmers and distributors in cases where analogue specialty services are distributed on a discretionary tier (analogous to expanded basic in the United States).

10. TSN, RDS and Discovery Channel are all analogue specialty services.
11. Class 1 cable systems and DTH systems are obligated to carry analogue specialty services[1]. This "must carry" status contributes to the high penetration levels achieved by analogue licencees.
12. The last analogue broadcast licences were granted by the CRTC in 1996.

(b) Category 1 Digital Licences

13. Category 1 digital broadcast licences were first granted by the CRTC in 2000. These services are licensed for distribution on digital cable and DTH and must be carried by Class 1 and Class 2 cable systems as well as DTH.
14. Given the benefit of the carriage assurances associated with a Category 1 licence, a Category 1 licence typically contains fairly onerous conditions (although less than analogue services), including:
    - restrictions on allowable program genres;
    - minimum levels of Canadian programming (hours); and
    - minimum levels of Canadian programming expenditures.
15. CTV Travel is a Category 1 digital service.

(c) Category 2 Digital Licences

16. Category 2 digital broadcast licences also contain conditions similar to Category 1 licences, including:
    - restrictions on allowable program genres;
    - minimum levels of Canadian programming (hours); and
    - minimum levels of Canadian programming expenditures.

[1] Class 1 cable systems are those cable systems that have more than 6,000 subscribers. Class 2 cable systems are systems with between 2,000 and 6,000 subscribers.

However, since Category 2 services are not "must carry" services, the licence conditions are far less onerous than those relating to analogue or even Category 1 services. This is due to the relatively low level of penetration expected for Category 2 services. Category 2 services must negotiate with distributors in order to obtain carriage.

17. Examples of Category 2 digital services include ESPN Classic Canada and Animal Planet.

Distribution Environment

18. In Canada there are approximately twelve million television households. Of those households, ten million households receive their television from either cable or direct-to-home ("DTH") distributors. Approximately four million households currently have digital service.
19. Cable distributors typically have both an analogue service offering as well as a digital service offering. Cable distributors are required to offer consumers a "basic service" that must include certain services (as defined by CRTC regulations).
20. Analogue specialty service licencees are distributed by cable on either the basic service or large, multi-genre analogue tiers. The tiers have high penetration.
21. Cable distributors generally offer Category 1 and 2 specialty service licencees on digital service offerings in packages and, on a more limited basis, on an a la carte basis. Where a cable distributor offers Category 1 services on a la carte basis, it must also offer that service as part of a package of programming services, so as to protect programmers from being isolated on a low penetration stand-alone basis. Thus, on the digital platform, only Category 2 services may be offered solely on an a la carte basis. Cable distributors are permitted to distribute digital versions of analogue services subject to negotiating terms of carriage with the programming services and these negotiations typically result in packaged distribution of the digital services.

Packaging

22. Specialty service programmers, including CTV Specialty, generally have limited control over the packaging of services. Most analogue services have to be carried on a discretionary programming tier (akin to expanded basic in the U.S.) unless both the programming service and the cable distributor agree that the programming service can be carried on basic. A limited number of analogue programming services must be carried on the basic service unless the programming service consents to distribution in a discretionary package. As noted earlier, Category 1 digital services have no packaging guarantees apart from protections against solely a la carte carriage. Apart from these basic regulatory rules, as programmers we attempt to influence packaging through negotiations with distributors. The CRTC has ultimate oversight on issues relating to packaging.

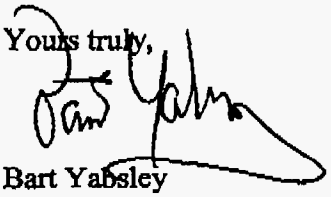
A La Carte

23. A very small portion of the distribution of our Category 1 and 2 digital services is achieved through a la carte offerings. For example, Animal Planet is one of the most successful digital networks in Canada in terms of distribution, having exceeded 1,000,000 subscribers earlier this year. However, the bulk of its penetration is through digital tiers. In fact, in the case of each of the two largest cable distributors (Rogers and Shaw) as well as the only two DTH distributors (Bell ExpressVu and Star Choice), less than 1% of such distributors' subscribers take Animal Planet on an a la carte basis. In total, our latest records indicate that only approximately 15,500 subscribers take Animal Planet on an a la carte basis from these four distributors. For clarity, for purposes of this letter I am using the term "a la carte" as equivalent to "stand alone."

24. Another example of the challenges that digital networks face in Canada is ESPN Classic Canada ("ECC") (a Category 2 service). ECC has only approximately 490,000 subscribers and has lost money each year since its launch in 2001 and unless it can become financially viable in the near future, we will consider closing the service. We have already closed WTSN, a women's sports digital service that was also launched in 2001, as a result of its financial performance.
25. In my opinion, the ability for a specialty service to be viable if offered exclusively on a stand-alone basis in Canada is extremely limited. The penetration rates that are achieved by a service that is distributed solely on an a la carte basis are so limited that neither subscriber fees nor advertising revenue would be sufficient to permit the service to provide programming that is compelling to viewers.
26. Note that this letter is not intended to be a legal review of the Canadian System nor does it address other key elements (e.g. foreign services) that comprise the Canadian System.

I trust the foregoing is helpful in understanding our broadcasting system and the role of a la carte distribution in Canada.

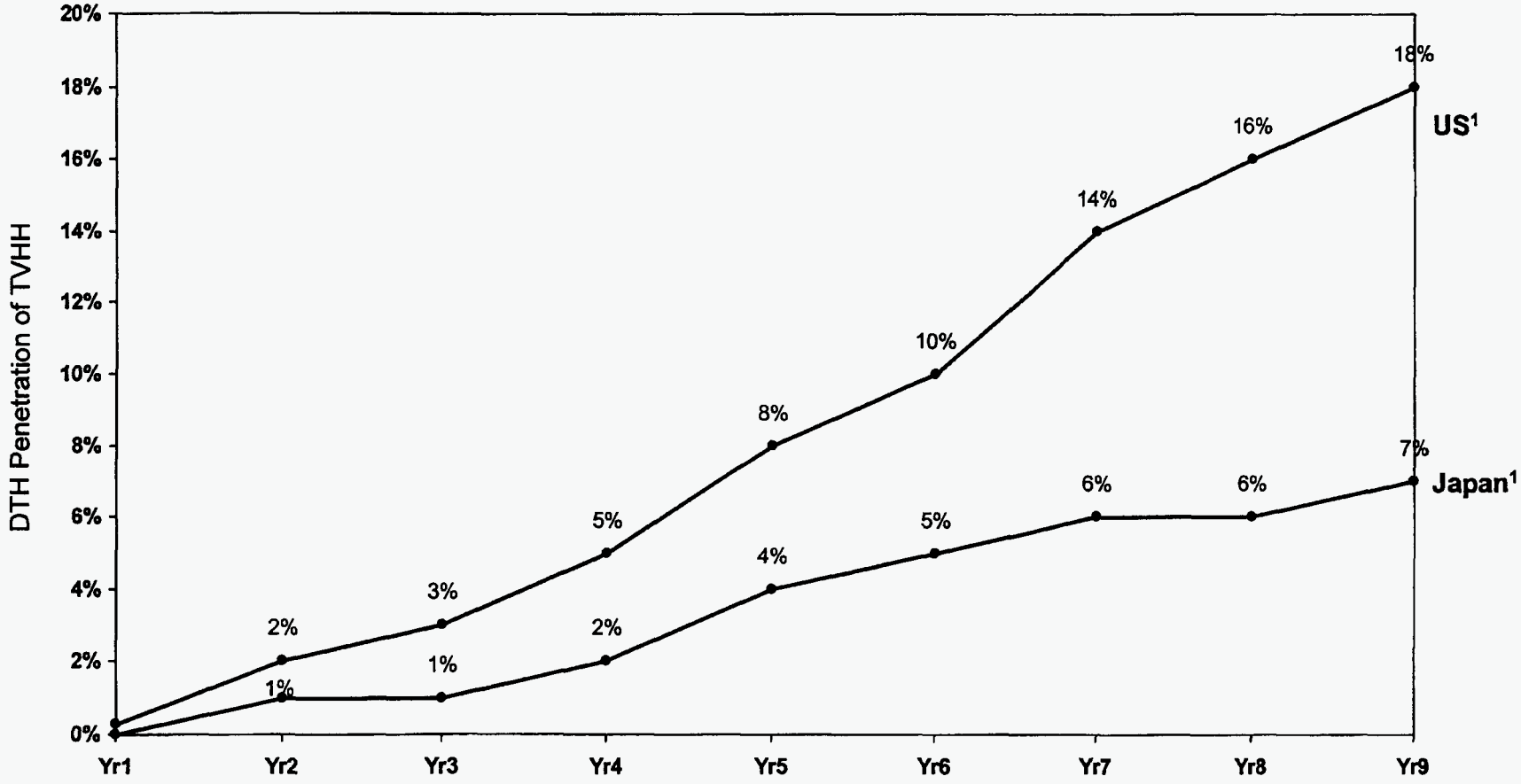
Yours truly,



Bart Yabsley
Executive Vice President
CTV Specialty Television Inc.

Exhibit 10

US vs. Japan Historical DTH Penetration Growth
(DTH Subscriber Penetration of TVHH)



[1] *Yr1 for DTH in the US was 1994, therefore Yr9 represents 2002 data; Yr1 for DTH in Japan was 1996, therefore Yr9 represents 2004 projections*

[2] *US Data: Based on averages from FCC 8th Annual Report on Video Competition 1-14-03, Veronis Suhler Industry Forecasts, 2003 Kagan Forecast, and analyst reports from Salomon Smith Barney, Morgan Stanley, and CSFB*

Japan Data: Jumin Kihon Daicho Jinko Yoran, March 2004 and data from the SkyPerfect website, 2004 projections based on Merrill Lynch report of May 10, 2004

Exhibit 11

EXHIBIT A

DECLARATION OF BEN PYNE

I am Senior Vice President of Affiliate Sales and Marketing for ABC Cable Networks Group. Among other responsibilities, I am responsible for working with the ABC owned television stations to negotiate retransmission agreements for the ten ABC owned television stations.

I attest that, in negotiating for retransmission consent, ABC offers MVPDs a cash stand-alone price for retransmission consent for the ABC owned stations. If the cable operator accepts that offer, that decision results in no additional obligation to carry any Disney/ABC programming. To the extent that any given MVPD decides not to accept ABC's stand-alone cash offer, and instead elects the alternative to negotiate to carry programming, that decision is made by the individual MVPD. We attempt to work with the MVPD to customize a reasonable offer to address their particular needs.

I hereby declare, under penalty of perjury, that, to the best of my knowledge, information, and belief, all of the factual information contained in this Declaration is accurate and complete.

Benjamin N. Pyne
Senior Vice President of Affiliate
Sales and Marketing
ABC Cable Networks Group

February 3, 2003